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CIA

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DEPARTMENT OF STATE

Washington, D.C. 20520

SECRET/SENSITIVE

February 9, 1982

25X1

File Pipeline

Senior Interdepartmental Group No. 15

To:

OVP	-	Mrs. Nancy Bearg Dyke
NSC	-	Mr. Michael O. Wheeler
DOD	-	COL John Stanford
JCS	-	LTC Edward Bucknell
Commerce	-	Ms. Jean Jones
USTR	-	Mr. Richard Heimlich
Treasury	-	Mr. David Pickford
CIA	-	

25X1

Subject: SIG Meeting on Next Steps re Poland and the USSR

Attached for your review are the papers assigned at the February 5 SIG on Poland.

1. Overview of Mission (NSC)
2. Extraterritoriality (State)
3. Energy Security Initiative (State)
4. Pipeline Status (CIA)

Treasury's paper on credit sanctions will be circulated as soon as it is received.

The SIG will reconvene at 3:30 on Wednesday, February 10, in Room 7219 to discuss these papers. Please telephone the name of your agency's representative to Sheila Lopez, 632-5804.

State Dept. review completed

L. Paul Bremer, III
Executive Secretary

Attachments:

As stated.

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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

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February 8, 1982

MEMORANDUM FOR THE HONORABLE WALTER J. STOESSEL, JR.
Chairman
Senior Interagency Group on Polish/Soviet Sanctions

SUBJECT: Draft Strategy Paper on the Extraterritoriality and Credit Limitation Mission

Attached is a draft strategy paper for the advanced preparation of the high-level mission to Europe on oil and gas equipment export controls and credit limitation.

Please distribute this paper to the members of the SIG.

Michael O. Wheeler
Staff Director

Attachment
Draft Strategy Paper

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Draft Strategy Paper for the High-Level Mission to Europe on Oil and Gas Equipment Trade Controls and Credit Limitation

Ultimate Objective

Denial of resources to the Soviet Union and the Soviet Bloc in order to limit the ability of the Soviet Bloc to build up its military forces and engage in external expansion. Additionally, the lightening of the necessity for an increasing diversion of Western resources to counter the Soviet military buildup and external initiatives.

Intermediate Objectives

Several policy initiatives can be and have been adopted and considered in order to help achieve the ultimate objective. This mission will concentrate on two: (1) the creation of delay and uncertainty over the ultimate completion or at least the date of coming on stream of the Siberian gas pipeline, (2) denial, restriction and/or the raising of the cost of Western transfer of resources to the Soviet Bloc in the form of medium- and long-term official and officially guaranteed credits.

Cost/Benefit Calculus

The benefit sought for in the form of the ultimate objective is long-term. Therefore peripheral short-term benefits should be foregone where essential, and short-term costs of substantial magnitude accepted to maximize the likelihood of achievement of the ultimate objective.

Strategies

The strategies to be applied to the intermediate objectives include: (1) Tradeoffs, especially short-term benefits and costs, for long-term benefits. (2) Delays. Any substantial delays in the completion of the pipeline will maximize costs to the Soviet Bloc, minimize eventual gains of the Soviet Bloc and damage Soviet Bloc creditworthiness. (3) Anxiety. Any increase in the anxiety level of Western governments, banks and industry concerning lending to or trading with the Soviet Bloc will tend to facilitate achievement of the intermediate objectives.

Constraints

Negotiating positions and tactics will be constrained by the following factors:

- The European environment, especially economic conditions, fear of the Soviet Union and resentment of the U.S. position of using the Polish crisis to attack the overall credit and trade climate with the Soviet Union.

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- Internal pressures, especially from the natural allies of the Administration and the labor unions.

- Resources, including availability and the will to apply them.

Initial Negotiating Positions

-- That the countries visited themselves place export controls on our subsidiaries and licensees.

-- That we jointly restrict official and officially-guaranteed credits to the Soviet Union and the Soviet Bloc based on some formula or ceiling and raise interest costs on any additional credits to a uniform level of ____% per annum over LIBOR.

Negotiating Tactics

-- Offers (to be used as necessary)

- Release G.E. rotors already in Europe (verify that there are only 22).

- Promise to promote use of embargoed eequipment on the Alaska pipeline (check likely construction schedule for the Alaska line).

- Offer compensation for additional storage costs, if any (estimate possible costs).

- Offer additional defense procurement, especially to Rolls Royce (estimate value).

- Offer energy alternatives package.

-- Threats (to be used explicitly or implicitly as necessary)

- Reduced purchases from Rolls Royce.

- Reprisals against subsidiaries and licensees violating our controls if we must impose them unilaterally.

- Use trip to propose consultations on mutual help in case of partial or bloc-wide default (implicit threat).

Resources Required

-- Money (estimate possible amount required).

-- Presidential authorization.

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-- Will. That is, the firm decision to impose the extended controls if the trip is unsuccessful.

Alternate Outcomes

-- Maximal (probability low)

- Export controls placed on U.S. subsidiaries and licensees by the European countries.

- Credit restrictions and/or substantial increase in interest charges.

-- Optimal likely (unilateral controls not triggered)

- Certain exports controlled (at least Dresser subsidiary and General Electric licensees)

- Credits made substantially more expensive

-- Minimal acceptable as a result of the trip but unilateral imposition of extended controls triggered

- Exports delayed through unilateral U.S. action but without giving the Allies the facile excuse that they were not effectively consulted and asked to cooperate in the only effective way in not undercutting our sanctions.

- Credit availability to the Soviet Bloc lessened through uncertainty and anxiety on the part of governments and banks.

Timing and Itinerary

Although speed is important, it is equally important to have the trip as well-prepared as possible, since this will be the last diplomatic effort before it may be necessary to take certain unilateral measures.

I would suggest visiting Rome first, since Italy is likely to be the most cooperative, and thus the trip might build up a certain "momentum of success."

In light of the above, I recommend the following itinerary: Leave Wednesday evening, February 17, 1982 for Rome, 18th in Rome; leave evening, February 18, for Bonn, 19th in Bonn; leave evening February 19, for Paris, 20th in Paris. Sunday, February 21 in Paris or London to assess the results of the Italian, German and French meetings and adjust negotiating techniques, if necessary. Monday, February 22 in London. Leave evening, February 22, for Washington.

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So as not to be dependent on commercial schedules, but more importantly to add emphasis to the importance of the trip, it is recommended that an official aircraft be used.

Miscellaneous

Embassy Tokyo must be kept fully informed of the purpose, progress and results of the trip in order to be able to make subsequent representations along the same lines to the Japanese government.

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Extra-territoriality

Four aspects of U.S. export restrictions have extra-territorial impact and could affect the Siberian gas pipeline.

(1) The December 30 restrictions on U.S. exports which force suspension of shipments already contracted. (Including 99 GE turbine rotors ($175 million) and a computer software package (1.6 million), that were ordered by European firms for the pipeline; and $110 million of Fiat-Allis bulldozer technology for Fiat, Italy).

(2) The December 30 restrictions on re-exports. (Prevents European firms from supplying the Soviets with turbines incorporating 21 rotors ($33 million) previously shipped from GE.)

(3) Possible controls on U.S. foreign subsidiaries. (Would preclude Dresser Industries, France from supplying 21 pipeline compressors ($30 million); and might limit Howmet subsidiaries in France and the UK from supplying rotor components.)

(4) Possible restrictions on products of U.S. "downstream" oil and gas technology transferred before December 30. Could prevent:

-- Alsthom-Atlantique (France) from selling turbine rotors (current contract 40 units -- $70 million; the Soviets are reported to seek 60 additional units);

-- AEG (FRG), John Brown (UK) and Nuovo Pignone (Italy) from supplying 47 ($304M), 21 ($200M), and 57 ($560M) pipeline turbines respectively, and;

-- Rolls-Royce from using U.S. derived technology, should they gain contracts for additional or replacement pipeline compressor station equipment.

Even if we were to deny successfully the Soviets all access to U.S. equipment and technology, it appears that the West Europeans could proceed with the pipeline project. In the key area of gas turbines, there are a number of alternatives to U.S.-source equipment and products of U.S. technology. Alsthom-Atlantique is licensed to produce GE-designed rotors. Rolls-Royce has in the past provided compressor/turbine units without U.S. parts or technology. Two Swiss firms -- Sulzer and Brown Boveri -- each produce a turbine without U.S. parts or technology that they believe could

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power the Siberian pipeline. Two German firms -- DEMAG and GHH -- are reported to be in the process of acquiring licenses for turbine and compressor technology from the Soviet Union. Each of these alternatives would increase the cost and, with the possible exception of the Alsthom option, delay the pipeline at least 6 months beyond the expected completion.

Whether these alternatives are pursued will depend on the determination of European governments to see the pipeline through against U.S. wishes. Margaret Thatcher recently wrote to President Reagan that: "the French, Germans, and Italians cannot and will not give up the gas pipeline project, whatever one may think of its merits. An accommodation on existing contracts is therefore essential to Allied unity over Poland."

The United Kingdom and Germany have made specific demarches requesting that the United States not prevent the fulfillment of pre-existing contracts for pipeline equipment. In NATO contingency planning last year, the United States agreed on a menu of sanctions which, in the event of Soviet military intervention in Poland, would include an embargo applying only to new contracts. Germany had argued that restricting shipments involving pre-existing contracts would amount to an expropriation and would be contrary to German law.

There is a very strong possibility that the French Government might prevent the United States Government from exercising effective control over Alsthom-Atlantique or over the French subsidiaries of Dresser and Howmet, as it did several years ago when the United States tried to prevent the French subsidiary of Fruehauf from selling semi-trailers to another French company for ultimate shipment to China.

When Western European governments agree with the objectives of U.S. extra-territorial controls, jurisdictional conflict can be resolved relatively easily. For example, in the 1960's the United States discontinued controls on the export of COCOM listed items from U.S. subsidiaries in COCOM member countries, because these countries had imposed parallel controls for such items. In 1981 the United States discontinued the requirement for a U.S. license for the re-export of U.S.-origin COCOM items from COCOM member countries provided that the case was unanimously approved in COCOM. Western European governments have not agreed to control the export of items not on the COCOM list, such as rotors for industrial gas turbine engines.

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When Allied governments disagree with U.S. control objectives, problems of jurisdictional conflict often become acute. We have experienced serious disputes not only with France, re China controls, but also with Canada, re Cuban controls, and with the United Kingdom, re Cuban and Libyan controls. Several of our Allies, including Britain, France, Australia, and Canada, have passed laws to impede or prevent compliance with certain U.S. regulatory measures by companies in their territories. Argentina's threat to nationalize a U.S. subsidiary of Ford, if it were not permitted to trade with Cuba in the mid-1970's, led to a significant relaxation of controls on U.S. subsidiaries trading with Cuba.

Permitting re-export of the 21 rotors already outside the United States might be considered as a carrot if needed to help persuade the Europeans to discontinue government-supported credits and credit guarantees.

Attachments:

Tab 1 - Legal Analysis.

Tab 2 - Impact of U.S. and Allied Controls on Western Exports to the USSR, including Data on Soviet Current Account Balance of Payments, Pre-existing Contracts, and Extra-territorial Controls.

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Legal Analysis

I. General Background - U.S. export controls on goods or technology are authorized by the Export Administration Act of 1979, as amended ("the EAA"). The EAA authorizes controls on exports of "[goods or technology] subject to the jurisdiction of the United States or exported by any person subject to the jurisdiction of the United States," where the controls are necessary for U.S. national security or foreign policy purposes.

EAA controls typically involve a legal requirement that an exporter obtain a validated export license from the Commerce Department before exporting particular types of commodities or technical data to particular foreign destinations. The Executive Branch has legal discretion to grant or deny such licenses in accordance with procedures and timetables specified by the EAA. Particular commodities and technical data and particular destinations subject to controls are identified in Commerce Department regulations. These regulations can be rapidly amended by administrative action.

The Commerce Department's regulations also require U.S. authorization prior to re-exports of certain U.S.-origin commodities and technical data from foreign countries and prior to the export from foreign countries of the product of certain U.S.-origin technical data. Such controls are designed to prevent transfers of controlled items to proscribed destinations from countries to which U.S.-origin commodities and technical data have been exported or re-exported.

II. New Controls - On December 29, President Reagan announced that:

> "The issuance or renewal of licenses for the export to the USSR of electronic equipment, computers and other high-technology materials is being suspended",
>
> and that
>
> "Licenses will be required for export to the Soviet Union for an expanded list of oil and gas equipment. Issuance of such licenses will be suspended."

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On December 30, the Commerce Department amended its regulations to: (1) suspend licensing for export or re-export to the Soviet Union of all commodities and technical data subject to a validated license requirement, and (2) impose a validated license requirement on export or re-export to the Soviet Union of specified U.S.-origin oil and gas transmission and refining equipment, and on exports of foreign transmission and refining equipment based upon U.S.-origin technical data exported after December 30.

The new regulations had the effect of blocking the issuance after December 30 of all licenses for the export of controlled items to the Soviet Union. The new controls, read together with standard Commerce Department regulations, also had the effect of preventing the issuance after December 30 of all licenses for re-export to the Soviet Union, even if the items involved were already in foreign hands on that date. Licenses issued prior to December 30 were not affected.

III. Conflicts of Jurisdiction with European Countries - The new U.S. controls are applied regardless of their effects on existing contracts. They have placed a number of European manufacturers dependent upon U.S. components in danger of being unable to meet their contractual obligations with respect to the pipeline. A number of our Allies have strongly urged that these contracts be permitted to go forward. Particularly with respect to the extension of export controls to cover transmission and refining equipment already abroad on December 30, they argue that the United States is attempting to control behavior within their sovereign territories in a manner inconsistent with international law.

There are some European uses of controlled commodities and technical data potentially subject to U.S. regulation, which the U.S. has not attempted to block by expanding export controls.

The U.S. has not applied its controls to exports from from subsidiaries of U.S. firms abroad, of non-U.S.-origin items, although the Export Administration Act provides domestic legal authority to do so. Many European governments deny the right of the U.S. under international law to exercise such controls over subsidiaries based in their countries.

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The United States also has not sought to control exports of foreign transmission and refining equipment based upon U.S. technical data where the data was exported from the U.S. before December 30. The legal grounds for a retroactive assertion of authority over the products of U.S. technology originally exported without any constraints upon the transfer of such derived products are tenuous.

IV. Response to Conflicts of Jurisdiction - It may be desirable to respond to European complaints regarding the application of U.S. controls to persons or property in Europe in connection with the furtherance of the U.S. objective of discouraging government-supported credits or credit guarantees for exports to the USSR.

This could be accomplished through issuance of licenses by the Department of Commerce to permit exports or re-exports of particular oil and gas commodities to the Soviet Union. Any such licenses would require modification of the Commerce December 30 regulations concerning suspension of licensing, and would lessen or be seen as lessening U.S. emphasis on the pipeline.

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Tab 2
2/7/82

Impact of U.S. and Allied Controls on Western Exports to the USSR, including data on Soviet current account balance of payments, pre-existing contracts, and extra-territorial controls
($ billion; U.S. share in parentheses)

	1979	1980	1981 est.	1982 est.
1(a) Soviet exports to the West currency balance of payments	21.0 (0.9)	25.3 (.5)	26.6 (0.4)	26.5 (NK)
(b) Soviet imports from the West (f.o.b.)	21.6 (3.6)	26.0 (1.5)	29.9 (2.4)	32.9 (NK)
(c) Soviet trade balance	-.6 (-2.7)	-.7 (-1.0)	3.2 (-2.0)	-6.4 (NK)
2. Composition of Soviet exports to the West				
(a)(1) Oil	9.6 ( )	12.0 ( )	11.5 ( )	10.5 ( )
(2) Gas	1.4 ( )	2.7 ( )	3.4 ( )	3.5 ( )
(b) Gold	1.6 ( )	1.8 ( )	9.0 ( )	9.0 ( )
(c) Other	8.5 ( )	8.8 ( )	2.7 ( )	3.5 ( )
(d) Total (Same as 1a)	21.0 (0.9)	25.3 (.5)	26.6 (.4)	26.5 (NK)
3. Composition of Western exports to the USSR				
(a) Agricultural Products	5.8 (2.4)	8.8 (1.3)	12.0 (1.5)	13.0 (2.0)
(b) Energy-related exports	3.4 (0.2)	NK (0.05)	NK (NK)	NK (NK)
(c) COCOM-listed items:				
(1) Committee review	0.2 (0.1)	0 (0)	0 (0)	0 (0)
(2) National discretion	- (-)	- (-)	- (-)	- (0)
(d) Other	(0.5)			
(e) Total (Same as 1b)	21.6 (3.6)	26.0 (1.5)	29.9 (2.4)	32.9 ( )

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($ billion; U.S. share in parentheses)

	1979	1980	1981 est.	1982 est.
4. Western denials of non-agricultural exports to the USSR				
(a) Oil and gas equipment and technology	- (-)	0.1 (0.1)	1.0 (1.0)	NK
(b) COCOM-listed items:				
(1) Committee review	- (-)	0.2 (0.1)	0.2 (.01)	0.2 (.01)
(2) National discretion	- (-)	- (-)	- (-)	- (-)
(c) Other	- (-)	.3 (.9)	0.5 (0.5)	NK
5. Value of denied exports subject to pre-existing contracts				
(a) Oil and gas equipment and technology	0 (0)	- (-)	0.2 (0.2)	0 (0)
(b) COCOM-listed items:				
(1) Committee review	0 (0)	- (-)	0 (0)	0 (0)
(2) National discretion	0 (0)	- (-)	0 (0)	0 (0)
(c) Other	0 (0)	0.3 (0.4)	- (.1)	0 (0)
6. Value of denied exports caught by U.S. controls on re-exports				
(a) Oil and gas equipment and technology	- (-)	- (-)	0.2 (0.2)	0 (0)
(b) COCOM-listed items:				
(1) Committee review	- (-)	0 (0)	0 (0)	0 (0)
(2) National discretion	- (-)	- (-)	- (-)	- (-)
(c) Other	- (-)	- (-)	NK	NK

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Impact of U.S. and Allied Controls on Western Exports to the USSR, including data on Soviet current account balance of payments, pre-existing contracts, and extra-territorial controls
($ billion; U.S. share in parentheses)

	1979	1980	1981 est.	1982 est.
7. Western denials of agricultural exports to the USSR				
(a) Value	N/A (N/A)	N/K ($3.2 billion)	N/K (N/K)	N/A (N/A)
Volume	N/A (N/A)	9 MMT (18 MMT)	N/K (N/K)	N/A (N/A)
(b) Value of denied agricultural exports subject to pre-existing contracts	N/A (N/A)	0 ($2.4 billion)	0 (0)	N/A (N/A)
(c) Value of denied agricultural exports subject to extra-territorial controls on re-export.	N/A	N/K	N/A	N/A

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Notes to the above tables:

1(a) and (b) figures refer to Soviet hard currency trade with non-Communist countries.

Symbols: a dash (-) means less than $50 million; 0 means zero; NA means not applicable; NK means not known

Soviet exports:

Soviet oil and gas exports (2a): The largest Western European import from the USSR is now oil; this is expected to switch to gas in 1986. U.S. imports under this heading are mostly fuel oil. Western export controls have heretofore had, and are expected in 1982 to have, only a marginal impact on Soviet oil and gas production and exports.

Soviet gold sales (2b): Gold sales are included in the Soviet export figures (1a). For the most part the USSR sells gold to obtain foreign exchange with which to finance imports from the West.

Other Soviet exports (2c): This covers a wide variety of items from chemicals to automobiles.

Oil and gas equipment and technology

Western exports (3b): In value terms, the largest item is wide diameter pipe. Total exports for pipe and other equipment for the gas pipeline, most of which would take place after 1982, are estimated at about $10 billion.

Western denials (4b): No country other than the United States controls oil and gas equipment and technology. Some dual-use COCOM items have oil and gas applications. France has apparently approved computer systems for the gas pipeline in circumvention of normal COCOM review procedures. The French have asked a Canadian firm to supply software for these computers, to replace a U.S. firm which had the contract subject to receipt of an export license.

Although the United States denied no licenses in 1978 and 1979, the controls led the USSR to buy from U.S. firms only as a last resort. One known effect since 1978, is that the Soviets have purchased several hundred millions of dollars worth of French gas-lift equipment rather than U.S. subsmersible pumps. There were no similar clear-cut clases in 1979.

During 1980 the post-Afghanistan tightened licensing policy was the basis for revoking Dresser's license for a drill bit plant. The technology had already been delivered; but the Soviets are withholding a final payment of $14 million pending receipt of training and start-up assistance.

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In 1981 the U.S. denied several other cases involving technology, e.g. for gas separation plants. On December 30, 1981, issuance of licenses was suspended for 200 Caterpillar pipelayers ($88 million), Fiat Allis technology for tractors ($631 million), GE rotors ($175 million), and pressure sensitive tape (annual sales about $25 million).

Pre-existing contracts (5a): Before the Dresser license was revoked, the drill bit plant was subject to a contract pursuant to a previously issued export license. The GF rotors were subject to sales contracts before these items were put under control on December 30, 1981. The Fiat-Allis tractor technology contract was subject to receipt of an export license pursuant to comprehensive technical data controls in effect for many years. However, Commerce had recommended approval before December 29. Senators Percy and Dixon and Congressman Findley maintain that this is low rather than high technology and that the Commerce suspension of license issuance for this technology is, therefore, at variance with the intent of the President's December 29 directive to suspend licenses for high technology.

Reexport controls 6(a): The GE rotors are subject to re-export controls.

COCOM exceptions

Western exports (3c(1)): COCOM normally approves exports for civil use which marginally exceed embargo limits.

- The figures exclude exports discouraged merely by the existance of the controls.

Western denials (4c(1)): As the only Allied agreed Afghanistan trade sanction, COCOM has, on a de facto basis, observed a policy of granting no-exceptions to the USSR since early 1980. No exports requiring Committee review have been approved except in extraordinary cases such as health and safety. In the absence of this policy, the 1979 level of exceptions might have continued (mostly computer equipment). Other COCOM members have also reacted positively to the December 23, 1981 U.S. suggestion for a similar no-exceptions policy on exports to Poland. In 1981, exceptions approved for Poland totalled only about $7 million, of which about $6 million came from the United States (mostly computer equipment).

Pre-existing contracts (5b(2)): In 1980 the United States suspended shipments under already issued licenses and subsequently revoked some of the licenses. The December 30, 1981, suspension of licensing for national discretion cases did not affect pre-existing firm contracts.

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Re-export controls (6b(2)): Over the years, other COCOM members have been particularly critical of U.S. denials of re-exports from their countries of items which the United States agreed in COCOM were approvable at national discretion. The June 25, 1981, waiver of U.S. re-export controls does not apply to such cases.

Other Exports

Western exports (3d): This covers primarily low technology industrial items not controlled by any Western country. However, the United States controls all unpublished technical data for industrial processes, regardless of the degree of sophistication, and the United States also unilaterally controls some commodities.

Western denials (4c): After Afghanistan, the United States denied exports for a steel mill, for an aluminum smelter, for phosphates, for transactions related to the 1980 Moscow Summer Olympics, and for an Ingersoll-Rand diesel engine assembly line for the Kama River truck plant. No other Western country imposed similar controls. Indeed, the French replaced a U.S.-Japanese consortium for the steel mill and the Germans replaced the U.S. portion of a U.S.-German consortium for the aluminum smelter. Thus, the U.S. share of the 1980 denials was greater than the total denied by the West.

The 1981 figure is the value of license applications returned without action pursuant to the December 30, 1981, suspension of all licensing (less amount shown in 4a and 4b(2)).

Pre-existing contracts (5c): The steel mill, phosphate, and Olympic denials affected pre-existing contracts.

Extra-territorial controls (6c): Our Allies have been critical of U.S. extra-territorial controls on non-COCOM listed items; but prior to the current controversy concerning gas pipeline related exports, celebrated cases concerned U.S. exports to destinations other than the USSR. This was primarily because, until 1980, U.S. denials of exports to the USSR were primarily of COCOM items or of items the U.S. was seeking to put on the COCOM list and none of the major cases affected by U.S.-Afghanistan measures involved re-exports, licensees, or subsidiaries.

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Denial totals - The totals exclude trade discouraged by the existance of controls. Virtually the only Allied cooperation in either Afghanistan or Polish export control sanctions has been the no-exceptions policy on exports to the USSR and to Poland of items requiring COCOM review. The dollar value effect of this cooperation has been smaller than the magnitude of Western replacements of U.S. denials of, e.g., grain, steel mill, and aluminum smelter sales. Therefore, the total Western denial to the USSR has been less than the U.S. share of that denial. If the Europeans find ways to circumvent U.S. denials of gas pipeline related equipment, this trend will continue in the years beyond 1982.

Pre-existing contracts 5(c): The United States has not hesitated to deny exports under pre-existing contracts, e.g., grain, Dresser drill bit plant, GE rotors, steel mill. Japan went along with stopping the Armco-Nippon Steel deal at first, but in view of the Creusot-Loire replacement contract, is unlikely to repeat such cooperation without firm European assurances. No other Western country has considered restricting pre-existing contracts.

Re-export controls (6c): The principal current controversy is the GE rotors.

Agricultural exports 7(a)(b)(c) - Fiscal Year: October-September

1979-81 figures for agricultural exports (3a) are for the calendar year. It includes US, Ec, Canada, Australia, New Zealand, and Argentina. Other important supplies of agricultural products include Brazil (soybeans), Thailand (rice, corn, manioc) and India (rice). Total Soviet agricultural imports in 1980 were $16.8 billion.

7(a) - The value of grain denied by the U.S. was about $3.2 billion; however, this does not provide a satisfactory basis for estimating the cost of replacing these exports to the USSR. In 1980, this would ignore price effects due to changes in the world price caused by the U.S. embargo and premiums paid by the USSR to attract replacements. For 1981, such comparisons are even more difficult because, in addition to price effects, substitution and displacement effects have an important effect on the amount denied by the U.S. (e.g. from the amount the USSR would have bought in the absence of the 1980 partial embargo) and from the rest of the world (e.g. the amount the Soviets would have imported, less the amount supplied by the U.S.), reflecting the move from the U.S. as the primary supplier to the U.S. as a residual supplier.

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During the embargo Soviet imports from non-U.S. suppliers offset progressively greater amounts of the agricultural products subject to the U.S. partial grains embargo. Major grains exporters (Australia, Canada and Argentina) all increased their exports to the USSR to record levels for the period. EC exports, although not large, stayed in the traditional range. By late 1981, there was little effect on Soviet grain imports due to the partial grains embargo.

In the absence of the embargo, U.S. agricultural product exports to the USSR would have reached significantly higher levels by now, although those estimated by the USDA (e.g., 35 million tons of grains) are extremely questionable.

7b - About 13 million tons beyond the 8 million tons of grains guaranteed annually in the US-USSR Long Term Agreement were under contract when controls were imposed, as well as soybean contracts for an additional 1 million tons.

7c - No known exports of products incorporating U.S. embargoed agricultural products were halted. Most agricultural products are shipped direct in bulk; however, wheat may be processed into flour and soybeans crushed for cake and oil. Significant displacement and substitution may occur as well.

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Energy Security Initiative

The Polish situation has not visibly slackened European determination to proceed with the Soviet gas pipeline project. The Germans, French and Italians believe the project will provide needed energy and jobs. A change in European perspectives is unlikely unless we, at a minimum, develop more credible energy alternatives. Even with these alternatives, success is questionable.

In the fall an interagency working group led by DOE developed a package of energy initiatives and identified potential alternative supplies of gas that would, in our view, reduce the European need for Soviet gas. An interagency team presented these alternatives and our market analysis to the Europeans in November. The Europeans were not convinced that the economics of the Soviet pipeline had changed significantly and continued to discount the security risks associated with the deal. They viewed the energy alternatives we presented as supplements, and not replacements for Soviet gas.

A renewed political appeal to the Europeans to postpone, suspend or cancel the pipeline will encounter heavy resistance. To have any chance of success, therefore, we must seek to change substantially the economic environment for European gas planning, offer the Europeans a political "cover" for reconsideration, address their employment concerns, and provide a more credible set of energy alternatives.

The elements of this package are controversial. Many have already been examined and rejected, albeit not usually on energy grounds. In any event, they could be difficult to achieve and costly to the U.S. But we believe it will take an effort of this magnitude even to open the door to European re-evaluation of the pipeline.

Domestic Energy Security Initiative

Domestic U.S. energy security actions could set a new context for West European energy planning and could reduce the Europeans' perceived demand for Soviet gas. We believe the following domestic measures could be considered as elements of an energy security initiative:

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Coal:

-- Provide substantial federal funding for coal port development. As a first step we would include $35-50 million in the FY 1983 budget for Baltimore Harbor dredging to ensure timely completion of the needed work and to increase U.S. credibility as a coal supplier. Budgetary outlays would be repaid when user fee legislation is adopted.

Action Required: For Baltimore: a) Divert funds from other "Water Projects" to Baltimore Harbor; or increase total budget allocation for "Water Projects"; (b) Congressional approval; c) For federal support of coal port development generally, the Administration would support the Abdnor Bill which would provide federal/local cost sharing.

-- Review the President's earlier decision against support for federal "eminent domain" legislation for coal slurry pipelines. This could improve the marginal competitiveness of coal, both in U.S. markets and abroad.

Action Required: a) Announce change in Administration policy; b) Propose amendments to current bill; c) Develop a strategy for obtaining Congressional approval.

-- Increase (or reinstate) support for coal-related research that has the potential for a near-term positive impact on coal use. Particular attention should be paid, where feasible, to reinvigorating cooperative R&D with the European allies, so as to shore limited resources and ensure rapid market penetration as technologies mature.

Action Required: a) Review U.S. coal-related R&D with the goal of speeding up development of technologies most likely to have an impact within 5-7 years; b) Request increased funding if necessary; c) Negotiate appropriate cooperative R&D agreements with European allies.

Oil:

-- Impose an oil import fee or an increased federal excise tax on gasoline as an energy security measure. This would create market incentives for further oil

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Action Required: a) Seek a legal determination whether authority in the Trade Expansion Act would permit the President to impose a fee without new legislation; b) Seek Congressional support for either Presidential action (under the Trade Expansion Act) or new legislation, depending on the legal determination.

— Fill the Strategic Petroleum Reserve (SPR) rapidly and, in exchange for increased stocking by IEA countries, agree to use these reserves flexibly in responding to oil supply disruptions affecting the U.S. or our IEA partners. U.S. willingness to participate in a flexible stock system would make it easier for the West Europeans and Japanese to slow the pace at which they are replacing oil with gas.

Action Required: a) Introduce legislation to broaden SPR authority and the antitrust defense for oil companies; b) Develop a strategy for obtaining Congressional approval.

Gas:

— Accelerate natural gas decontrol. Decontrol would increase the efficiency of U.S. natural gas use, encourage expanded domestic production, and thereby back-out oil and reduce American competition for long-haul (particularly African) LNG supplies.

Action Required: a) Introduce accelerated decontrol legislation; b) Develop a strategy for obtaining Congressional approval.

— Offer government guarantees to assure completion of the Alaskan Gas Pipeline. This would demonstrate U.S. commitment to develop fully its own energy resources and to reduce dependence on oil and gas imports, and offer us leverage to increase the volume of European equipment used on the Alaskan pipeline. (It should be noted, however, 1) that the President has assured the Congress that financing for the pipeline would be all private, and 2) that the pipeline package provides for preferential treatment for U.S. and Canadian equipment suppliers.)

Action Required: a) Amend current legislation to authorize U.S. financial guarantees; b) Explore prospects for increased European equipment sales; c) Congressional approval.

Nuclear:

— The U.S. would permit (and encourage) construction and operation of a major nuclear waste facility and accept European waste for treatment and medium-term storage. This could alleviate European public concerns about nuclear waste buildup and facilitate an expanded nuclear power program.

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Action Required: a) Introduce legislation permitting import of nuclear wastes; b) Develop a strategy for obtaining Congressional approval; c) Find a site; d) Provide incentives for construction and operation.

-- Support establishment of an international High Level Group charged with identifying obstacles to nuclear power development and suggesting solutions.

Action Required: The President should call for the establishment of such a group at the Versailles economic summit.

An Accelerated International Gas Alternatives Effort

Internationally, we would accelerate efforts to increase the availability of alternative gas supplies and to undertake a joint assessment of European gas demand. In particular, we would seek to take advantage of the following opportunities and consider the following courses of action:

-- The Netherlands is increasingly aware of its pivotal role in Western European gas security, and beginning to appreciate the earnings which will be lost with phase-out of gas exports. The Dutch might be receptive to a proposal-- with appropriate incentives-- that they revise their planned phase-out of gas exports, and coordinate any phase-down with the accelerated development of Norwegian gas fields.

-- The new Norwegian Government might agree to accelerate development of its gas reserves if means can be found to overcome technical obstacles and to insulate the Norwegian economy from the inflationary impact and foreign influence that might accompany such development.

-- The U.K. can accelerate development of its gas reserves and decontrol the gas industry. This would promote British self-sufficiency and might eventually open up the possibility of UK gas exports to its European neighbors.

-- Sweden should explore the potential for for a gas pipeline from Northern Norway, through Sweden to the Continent, that could carry gas from the Norwegian Tromsa field.

-- Denmark should continue its policy of expedited development of its gas resources.

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Action Required: a) Seek an early opportunity to discuss gas supply issues with the North European leaders in order to encourage reevaluation of gas policies. b) Encourage these North European nations to undertake promptly detailed consultations on coordination of their gas production plans.

-- Convince Canada to allocate a portion of its gas reserves, particularly in the East Arctic, to help the Europeans meet their gas needs.

Action required: a) Begin discussions with Canada to urge partial dedication of their Eastern and Arctic gas reserves and LNG development to serve Europe (rather than the U.S.); b) Would require cancellation of agreed company-to-company contracts (which are still pending U.S. and Canadian regulatory approval).

-- The International Energy Agency is assessing natural gas prospects to the year 2000. We would press our view that West European gas demand projections are overstated and that gas supply prospects--other than from the USSR--are realizable.

Action Required: Press for early completion of an IEA study within the IEA/SLT, which we chair.

-- The Belgians and the Dutch have indicated that they may take little or no Soviet gas since they have not received any equipment contracts. We should urge them to make this a firm decision.

Action Required: Meet with Belgian and Dutch officials and encourage them to take a tough stand against the Soviets.

-- The U.S. could indicate willingness to discuss how development banks might substantially increase energy lending to LDCs. Expanded IBRD energy lending has strong European support, particularly in France, the Netherlands, and Italy.

Action required: a) Review our position on LDC energy lending; b) Initiate discussions with our allies and MDB officials on how we could most effectively spur increased LDC energy investment.

With our allies we should initiate approaches to prospective LNG exporters to sound out whether they would be prepared to accelerate gas development were the Soviet pipeline deal curtailed. It is likely that these projects will not proceed rapidly if the Siberian pipeline is built and supplies cheap Soviet gas to Western Europe. We will want to concentrate on:

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-- Algeria. Algeria has a long history of LNG exports to the continent and substantial infrastructure is already in place for shipments to France and Italy. Disagreements on price have been holding up these operations, but France has just reached a long-term accord.

-- Cameroon. Large gas reserves have been proved, but there are no concrete development plans. Consideration of financial and technical options is at an advanced stage.

-- Nigeria. The Bonny LNG project which was at an advanced stage of planning, now appears to have unravelled for lack of financial and managerial resources, and lack of firm commitment by the Nigerian Government.

-- Qatar. The Government is aware of substantial reserves and has an interest in undertaking a major export program.

-- Trinidad and Tobago. The French are interested in importing LNG from Trinidad and Tobago, but are concerned about U.S. competition for this source.

Action required: a) Review U.S. gas import policy to see whether it can or should be modified to foster increased supplies of LNG to Western Europe; b) Arrange a meeting with FRG, Italian and French officials to consider how a coordinated approach to LNG exporters could benefit West European countries.

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